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AUTHOR Atkinson, Robert D.
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ABSTRACT

The recession has fueled calls in Congress to extend and expand unemployment insurance (UI) benefits. Although UI expansion is needed in the short run, the program is also in need of more fundamental and permanent reform to transform it from an industrial era program to one that is better suited for the New Economy. Policymakers must take the following steps now: (1) expand eligibility to include all low-wage and part-time workers who lose their jobs through no fault of their own; (2) set a limit on the practice by states of cutting UI taxes to become more "competitive" (raise the Federal Unemployment Insurance Tax rate from 0.8% to 1.1% and the wage base on which it is assessed from $7,000 to $11,000 and index it to inflation; give states more flexibility in running their UI systems; and exempt the first $2,500 of UI benefits from federal taxation); (3) make UI a trampoline rather than just a safety net by making it easier for workers collecting UI to enroll in training; (4) require states to hold employees responsible for the costs they impose on the system through layoffs; and (5) strengthen UI's anti-recession function by lowering the threshold that triggers extended benefits. (Contains 18 endnotes.) (MN)

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Modernizing Unemployment Insurance for the New Economy and the New Social Policy

Policy Report

Robert D. Atkinson

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Modernizing Unemployment Insurance for the New Economy and the New Social Policy

By Robert D. Atkinson

The recession has fueled calls in Congress to extend and expand unemployment insurance (UI) benefits. While UI expansion is needed in the short run, the program is also in need of more fundamental and permanent reform. It must be transformed from an industrial era program to one that is better suited for the New Economy.

Unemployment insurance is a federallymanaged, state-run program. Employers pay a tax on each worker based on the overall unemployment rate, the level of state benefits, and their "experience rating," which is based on the magnitude of prior claims made by their workers. When workers lose jobs through no fault of their own, they are eligible to collect benefits for a maximum of 26 weeks, provided they have earned a certain minimum amount and worked a minimum number of weeks in the prior year.

When Congress created the UI system in 1935, the goal was to give income support to full-time workers between when they were laid off and called back to work on their same jobs. The program was seen as helping predominantly manufacturing, unionized workers in permanent, full-time jobs who were familiar with unemployment insurance. All states were required to have a program and most states had similar programs in terms of benefit levels and qualifications. Finally, the program was designed to boost the purchasing power of laid-off workers in economic downturns in order to provide a counter-cyclical boost to the economy.

Almost 60 years later, the New Economy has changed all of these conditions. Today, most workers are never called back to their previous jobs. In 1970, about 38 percent of job losers were on temporary layoff; by 1995, fewer than 25 percent were. Moreover, in a labor market being transformed by technology and trade, many unemployed workers need to upgrade their skills to get comparable or better jobs. Most jobs are in the non-unionized service sector where fewer workers are familiar with how the UI system works. Moreover, approximately 30 percent of Americans work part-time or have other non-traditional work arrangements. A large share of the growing number of contingent and part-time workers (this includes many workers who formerly collected welfare) will not qualify for UI because they do not earn enough, they work part time, or are new to the labor force. As we move into a world where everyone is expected to work, we need to uphold our bargain with those who left welfare for work

600 Pennsylvania Avenue, SE, Suite 400 • Washington, DC 20003 • 202-547-0001 • Fax: 202-544-5014 • E-mail: ppiinfo@dlcppi.org • WWW: http://ppionline.org

so that they do not fall back onto public assistance simply because they, like so many other workers, earn little, work part time, or change jobs often.

Finally, over time states have made the program more restrictive. While federal law mandates states to have a UI system, it does not prevent them from having only a one system. Competitive pressures have increased for states to have "good business climates," leading many to cut benefits and restrict eligibility. And an increasing percentage of the unemployed live in states with lower than the national average of recipiency.

As the nation's principal safety net for helping those who lose their jobs, the unemployment insurance system has lagged behind these changes. While approximately half of all unemployed workers received UI benefits in the 1950s, today approximately one-third do. As a result, UI now plays a diminished counter-cyclical role in helping to moderate recessions. Even so, without any UI, recessions would be an estimated 17 percent deeper.[1] And in a more competitive, global, and technology-driven economy, a weakened UI system reduces the safety net for workers, making them less likely to support the New Economy. If we are to ask Americans to embrace the New Economy, we need to give them the support and tools needed to do so.

It is not just a matter of more generous benefits and eased eligibility, as advocated by many liberals who would like to see the United States move more into the direction of a European-like welfare state unemployment system. In their goal to be compassionate, many continental European nations have gone too far, providing extremely generous benefits for long periods of time. Not surprisingly, since these nations are essentially paying workers not to work and distributing purchasing power from those who work to those who do not, unemployment rates remain chronically high. And as workers' skills become obsolete from rapid technological change, the European system has the added detriment of keeping workers out of the labor market so long that their skills get even more obsolete, creating high levels of "structural" unemployment.

While some liberals dream of a European-style welfare state, conservatives have focused on keeping benefits low to cut government-imposed costs on business. The result is a bare-bones system that limits qualifications, duration, and benefits to the bare minimum, and is not only unfair to workers, but does little to help Americans cope with and accept an increasingly volatile New Economy labor market. Moreover, it limits the role of UI as a counter-cyclical stabilizer.

As a result, we need a Third Way approach to unemployment insurance reform that not only gives workers the right incentives to remain at work and get back to work, but also provides them with adequate benefits when they lose their jobs. We need a system that recognizes that all employees who lose their jobs through no fault of their own should be eligible for UI, even if they are new to the labor market or making low wages. We need a system that serves as a trampoline, not just a safety net, by helping workers upgrade their skills while collecting benefits in an ever-changing economy. We need a system that recognizes the advantages of state-administered programs but provides a federal floor under which all states operate. Bringing the nation's unemployment system into the New Economy by crafting such a Third Way approach will not only help workers in a more turbulent labor market, it will reduce the duration and depth of economic downturns.

It is incumbent upon Congress and the states to act now to modernize UI to meet the realities of the New Economy. Policy makers should take five steps:

- **Expand eligibility to include all low-wage and part-time workers who lose their jobs through no fault of their own.**
- **Set a limit on the race to the bottom—the practice by states of cutting UI taxes to become more "competitive"—by raising the Federal Unemployment Insurance Tax and the wage base it is assessed on.**
- **Make UI a trampoline, not just a safety net, by making it easier for workers collecting UI to enroll in training.**
- **Require states to hold employers responsible for the costs they impose on the system through layoffs.**
- **Strengthen UI's anti-recession function by lowering the threshold that triggers extended benefits.**

Step One: Make it Easier for All Workers Who Lose Their Jobs Through No Fault of Their Own to Qualify for UI.

Although UI rules vary from state to state, states typically exclude people who do not fit the traditional notion of a laid-off worker. Workers coming off welfare, and low-wage and non-traditional workers in general, face a number of barriers. First, states set a minimum threshold on earnings in a base period, which is typically defined as the first four of the last five full quarters a worker is employed. But low-wage workers are almost twice as likely to have worked fewer than 35 weeks prior to unemployment than higher-wage workers. In some states, part-time and/or low-wage workers may not earn enough. For example, a worker in Florida must earn $3,400 in the base period to be eligible, meaning a person earning minimum wage at a half-time job must have worked for 33 weeks.

Most base period requirements also eliminate workers who have recently reentered the work force and have gotten get laid off, or result in those workers getting benefits for a significantly shorter duration. For example, in New Mexico claims are based on wages earned in at least two-quarters of the prior 12-month period. While intended to give states time to gather employment records in the pre-Internet era, such base period requirements should no longer be an excuse for keeping deserving workers off of UI.

Some have objected to letting these workers with so-called "weak attachments to the labor market" from collecting UI, even when they are legitimately laid off, claiming that UI must be "earned" based on substantial employment. But this confuses UI with a benefit like Social Security, which indeed must be earned. If a person begins work at an organization and through no fault of her own gets laid off shortly thereafter, there is no justification for not providing UI to her, while at the same time providing it to a worker who had worked there 3 years. Both were working in good faith and both got laid off through no fault of their own. Likewise, it's not fair that a high-wage earner who is laid off can qualify by meeting minimum earning requirements after working only 4 months, but a low-wage earner in the same position cannot qualify. In short, the notion that workers should not be able to collect UI unless they have significant attachment to the labor market is a vestige of the old economy.

Finally, in order to be eligible for UI

benefits, workers must be looking for and willing to take full-time work. Yet many workers, including many former welfare workers, can only work part-time. The result is that part-time workers who are laid off are one-third less likely to receive UI. Like they do for full-time employees, the employers of part-time workers pay unemployment-insurance taxes on their wages and salaries, but in most states part-time workers do not receive the benefits of those taxes when they are unemployed. It is fair that full-time workers who are laid-off who are not willing to go back to work full-time should not be able to collect benefits. However, it is not fair that workers who are working part-time and are laid off through no fault of their own should be required to change the circumstances of their work lives by going back to work full time in order to qualify for UI benefits.

As a result of all of these restrictions, only about 20 percent of unemployed welfare workers will collect UI benefits under the current rules.[2] Some welfare advocates propose that we should loosen restrictive policies governing welfare in order to help those who have left welfare for work and who have lost their jobs in the recession. But this is at least a second-best solution. The best solution is to reform unemployment insurance so that those who have left welfare for work get the same benefits as all other workers who lose their jobs through no fault of their own.

As a result, **states should:**

- **Let workers who are available only to work part-time qualify for UI if they were laid off from a part-time job.** A number of states have considered such legislation, and Minnesota recently passed legislation allowing this.

- **Institute alternative base period requirements.** At least a dozen states have alternative base periods that let workers qualify on the basis of their earnings in the most recent quarter if they are otherwise ineligible under the standard base period system. Doing this would enable 400,000 more individuals to be eligible for coverage.

- **Lower minimum earning requirements and allow workers to qualify based on the number of hours worked.** States with high earning requirements should lower them so that low-wage earners do not have to work as long to qualify. Likewise, low-wage workers should also be able to qualify based on number of hours worked. Oregon recently passed legislation allowing workers to be eligible for UI benefits if they have worked more than 500 hours, regardless of how much they have earned. Washington also passed a similar law requiring 680 hours of work, while also accommodating those who qualify under the alternative base period.

- **Require companies to report wage data electronically on the Internet.** One reason most states base UI claims on the prior four-out-of-five quarters is that it takes them so long to process worker earnings information from companies. A large share of companies still report wage data by sending in paper forms. In an Internet era, states should be able to access this information the same day a company files it. If states made it easy to file online and required it, they could automatically base eligibility on the last full quarter worked.

- **Allow workers to qualify if they are not available to work evenings or weekends because of child care**

responsibilities. Many workers coming off of welfare cannot work evenings or weekends because they must take care of their children. Yet, 10 states will declare a worker ineligible for UI if they are not available for work on evenings or weekends because of lack of childcare.[3] Six states will deny workers benefits if they cannot get to work on evenings or weekends because public transportation is not available. As long as these workers were working day shifts when they got laid off, and have compelling reasons that make it difficult for them to work alternative shifts, they should be eligible.[4]

Step Two: Set a Limit on the Race to the Bottom

As competition to attract business has heated up, efforts by states to cut UI taxes on employers, and hence benefits, in the name of a good "business climate" have grown. State legislatures face considerable political pressures every year from businesses and business organizations to cut UI taxes. Business points to lower tax rates in other states and warn that without a tax cut, their state will lose the race to attract and grow more jobs. Moreover, many state unemployment insurance agencies actively work to limit claims. For example, Oklahoma's UI Web site urges employers to appeal decisions by the state whereby a worker was granted benefits. It gives employers the answer to "How can an employer reduce benefit charges?" Not surprisingly, UI taxes in Oklahoma are among the lowest in the nation.

Studies have found that without such state competition total UI tax rates (and by extension, benefits) would be as much as 58 percent higher.[5] Some changes states have made, such as tightening up the restrictions on workers who voluntarily quit, made sense. UI was not generally designed to pay benefits to workers who quit of their own volition. But other changes were made solely to cut UI taxes paid by business.

Many states seek competitive advantage by having the lowest benefits and taxes. For example, an unemployed worker in Mississippi averages only $146 a week, compared to a Hawaiian worker who receives $269. The minimum weekly benefit a worker gets is only $10 in Oklahoma, compared to $94 in Oregon. Maximum benefits range from $190 in Alabama to $715 in Massachusetts. In many states, large shares of workers receive considerably less than half their earnings. For example, because the maximum weekly benefit in Arizona is only 38 percent of the average weekly wage, most laid-off workers there suffer large income drops. Many states also control costs by keeping eligibility rules strict. Only 18 percent of unemployed workers in New Mexico received UI in 1995, compared to 72 percent in Rhode Island. From 1987 to 1996, UI recipiency varied from 19 percent of the unemployed in South Dakota to 55 percent in Alaska.

Even when looking just at the rate of coverage of workers who lose their jobs (as opposed to those who quit or are new entrants to the workforce), the rate of coverage varies from 105 percent in the Pacific region (Alaska, California, Hawaii, Oregon, Washington) to only 64 percent in the West South Central region (Arkansas, Louisiana, Oklahoma, Texas).[6] While some of this variance was a result of different economic conditions, the lion's share was due to differences in the tightness or looseness of state policy. As a result, as more Americans have moved south and west to states with more stringent restrictions and lower UI recipiency rates, an increasing percentage of the unemployed live in states

with lower than national average of recipiency and lower benefit levels. One study attributes approximately 50 percent of the decline in national recipiency rates to the internal migration of Americans to states with more stringent restrictions.[7]

Absent federal intervention, many states will continue to seek to reduce UI benefits and taxes below levels that are equitable and reasonable. There only are two ways to fix this. Congress could set minimum levels of benefits and qualification requirements. However, while this has the merit of setting a national floor, doing it right would require the Department of Labor to impose complicated and bureaucratic rules. An easier solution would be for the federal government simply to set a national floor, increasing the UI taxes that employers pay to the federal government and remit this money back to state UI trust funds. Currently, under the Federal Unemployment Tax Act (FUTA), employers are required to pay a 6.2 percent tax on the first $7,000 of each employee's annual pay. As long as their state has an unemployment insurance program that meets federal guidelines (all 50 states do), then the employer receives an offset credit on 5.4 percent of the tax, making their effective tax rate 0.8 percent (5.4 percent plus 0.8 percent equal to 6.2 percent). Theses funds go to pay for program administration and extended benefits. States add their own taxes on top of this. Raising this tax 0.3 percent (in actuality, reducing the offset tax credit from 5.4 percent to 5.1 percent) would raise many states' minimum tax rates, thereby reducing the pressure on them to keep benefits and eligibility low.

Some might argue that raising UI taxes a modest amount in approximately 20 states would be bad for the economy. There are two components to this argument. First, some argue that certain firms would hire fewer workers. After all, their costs would go up. But this is unlikely since the cost increase as a percentage of wages in states seeing an increase is likely to be very small, approximately half of 1 percent. Moreover, since most firms in the states facing higher taxes would see their taxes go up (by a small amount), the effect would be felt equally. And since the key factor determining hiring is demand for a firm's products and services, firms would be unlikely to change their hiring practices. Even if it were to lead some firms with higher increases to curtail some hiring, monetary policy set by the Federal Reserve Board would completely overwhelm any such micro-level firm decisions. In the face of temporary, one-time, higher national unemployment rates, the Federal Reserve would cut interest rates bringing unemployment rates back to their original level. In short, the job loss arguments against modest increases in UI taxes are red herrings designed to defeat any such proposals.

In fact, in contrast to the arguments of opponents, such a national floor would actually increase employment. This is true because it would reduce regional disparities in unemployment and economic performance, allowing the national economy to operate closer to full employment. Because more UI benefits are paid during economic downturns, the unemployment system has the benefit of smoothing out the business cycle, minimizing the loss of purchasing power when workers are out of work. However, because the lion's share of UI taxes are paid by businesses to states, states must raise UI taxes when unemployment rates go up in their state. If one state's economy is doing poorly, its UI costs go up, requiring it to raise taxes. This in turn marginally reduces the competitiveness of companies in the state, slowing the state's economy even more, but

raising the relative competitiveness of companies in other states, spurring their growth. The result is that the UI system has the unfortunate side effect of exacerbating regional economic differences.

At any time unemployment is not evenly spread throughout the nation, some states have higher rates and others have lower rates. Because of these differences the Federal Reserve Bank is more constrained than they would otherwise be in lowering interest rates to stimulate full employment. If all states had 5 percent unemployment, the Fed might lower interest rates to raise employment with no inflationary effects. However, if the national rate were 5 percent but half the states had a 7 percent rate and the other half had a 3 percent rate, lowering interest rates to boost demand would cause inflationary pressures in the states with the lower unemployment rates. Increasing the FUTA tax and nationally distributing it to states based on their unemployment rates would have a regional counter-cyclical effect by raising demand modestly in high unemployment states and lowering it modestly in low unemployment states, allowing the overall economy to be run closer to full employment. Therefore, **Congress should:**

- **Raise the minimum wage base on which UI taxes are levied from $7,000 to $11,000 and index it to inflation.** Thirty-two states assess UI taxes on a wage base below $11,000, with 11 at the federal minimum of $7,000. If an employer in a state with the taxable wage base of $7,000 hires two low-wage workers collectively earning $14,000, he pays taxes on all $14,000. In contrast, if he hires one worker for $14,000, he pays taxes on only the first $7,000. Raising the taxable wage base results in a more efficient and fair collection of UI taxes by reducing the disproportionate employer tax burden on the wages of low-wage workers. The national floor on the taxable wage base hasn't been increased since 1983, in spite of the fact that the consumer price index has increased over 70 percent. Raising the wage base on which taxes are levied can be revenue neutral in most states, if the 32 states with a taxable wage base below $11,000 reduce their tax rates accordingly.

- **Increase the effective federal unemployment insurance tax rate from 0.8 percent to 1.1 percent and remit the funds to states based on their rate of unemployment.** (As discussed above, this would be done by reducing the FUTA tax credit from 5.4 percent to 5.1 percent.) Increasing the federal tax would create a national floor for UI taxes and benefits since the tax rate in all states would be at least 1.1 percent on the first $11,000 of earnings. Because the floor is below the rate most states now set, these responsible states would likely use the revenue remitted back to them to offset reductions in their state rates by a corresponding amount. Employers in approximately one-third of the states now paying less than 1.1 percent in state UI taxes, would see their tax rates rise. But these states could use the increased revenues for a variety of purposes including: job training; job search assistance; more generous benefits, particularly for low-wage earners (including dependent benefits and benefits for workers in training); and/or broader eligibility (e.g., allowing part-time workers to qualify, instituting alternative base periods). These revenues would be collected by the federal government and remitted automatically back to the states on the basis of their

insured unemployment rate (the number of workers collecting unemployment insurance as a share of the total number of civilian workers in the labor force).

- **Return to the states the excess unemployment taxes in the federal UI Trust Fund**. Congress should not spend taxes collected from employers for unemployment insurance to pay off the national debt. For example, in 1998 FUTA revenues were $6.2 billion, of which only $3.6 billion was appropriated for state and federal UI administration. These should be returned to state UI trust funds, allowing states to reduce taxes a proportionate amount.

- **Give states significantly more flexibility in how they run their UI systems.** There are many advocates for devolution of UI responsibilities to the states, including businesses and states themselves. And indeed, giving states more flexibility can reduce the considerable regulatory straightjackets and micro-management from Washington that limit them from making needed changes. But at the same time, without a federal floor and performance requirements, states will engage in a race to the bottom for benefits and taxes. Therefore, while the federal government should set a floor, it should also give states considerably more flexibility in how they operate their UI programs. In exchange for a higher federal floor, states should be given more flexibility. But accountability measures, including indices of how well workers are able to access UI benefits, should be part of any federal UI tax allocation formula.

- **Exempt the first $2,500 of UI benefits from federal taxation.** In 1986, Congress subjected all UI benefits to federal income taxes, lowering the after-tax value of benefits and reducing the rate at which workers collect UI. Exempting a share of UI benefits from federal taxes would provide a more generous safety net, while preserving incentives for most workers to get back to work.

Step Three: Make UI a Trampoline, Not Just a Safety Net

At its heart the UI system is designed for a world in which job skill requirements remain constant. The overriding goal of the system, and of most who administer it, is to get workers back to work as soon as possible in their existing occupations. And the way state programs are evaluated—on the duration of benefits paid—puts pressure on states to get workers back to work quickly, even if they could benefit from skill upgrades. Yet, in a rapidly changing labor market based increasingly on technology and higher-skill work, many unemployed workers need to upgrade their skills to succeed. Moreover, in a knowledge-based economy, helping workers upgrade their skills between jobs can boost productivity and economic growth.

As a result, **states should:**

- **Make it easier for laid-off workers to collect UI while they are upgrading their skills for new employment.** Under the prior Job Training Partnership Act, states were prohibited from denying benefits to unemployed workers who are in qualified training programs. However, the legislation left it up the states to define "qualified." Moreover, as an oversight, Congress failed to include a similar provision in 1998 Workforce Investment Act (WIA). As a result, many states do not make it easy for workers to

collect benefits while in training.

Some states inform workers that they cannot collect benefits while in training unless their skills are "obsolete," as if only the "buggy whip braiders" and "bowling alley pin setters" of the New Economy should get new skills. Many states don't tell workers that they can collect while in training. And in some states, the breadth of courses and training providers that qualify is limited. For example, some states do not consider English as a Second Language courses or Adult Basic Education courses as qualified training, yet the individuals who take these courses are probably the ones most in need of boosting their skills. Other states automatically disqualify someone enrolled in higher education, even if they are in classes that are clearly career oriented (e.g., IT systems management) and short-term (e.g., under a year). The end result is that in some states it is difficult to qualify for benefits while in training. Many Workforce Investment Boards do little to encourage workers to collect UI while in training. For example, while Tennessee's state Workforce Investment Board's Web site promotes lifelong learning stating, "As the job market changes, your skills need to keep up," it doesn't mention that laid off workers should consider using UI funds to support themselves while in training.

With this in mind:

- **Congress should amend WIA to make it clear that workers in WIA-qualified training must be eligible for UI benefits.**

- **States should enact similar legislation and administrative rules making it clear that workers in approved training can collect UI benefits.** Some states have already enacted such legislation. Maine recently clarified that any workers participating in training approved under the Workforce Investment Act are automatically entitled to UI without having to also seek new work. Another Maine law made clear that enrollment in a degree-granting program cannot be the sole cause of denial of benefits. In addition, Nebraska enacted a law covering both WIA training and activities funded under the federal Welfare to Work program.

  To be fair to the employers who laid off the workers, however, states should charge back to the employer's account only some of the costs if workers enroll in training. This is the case since it can be assumed that without training, the worker would get back in the labor force sooner and collect benefits for a shorter time.

Provide extended benefits to dislocated workers who are collecting UI and are in training. For many workers needing to upgrade their skills, a 26-week program is simply not enough time in which gain the needed skills. As a result, a number of states, including California, Massachusetts, Michigan, New Jersey, Oregon and Washington, provide additional weeks of benefits to workers who have been dislocated and are in approved training program. For example, New Jersey provides an additional 26 weeks of UI support to such workers.

Another way states can support unemployed workers seeking to upgrade their skills is to waive tuition costs at public institutions. For example, Rhode

Island lets UI recipients take any course, for credit, at any state-operated college or university and waives tuition and registration fees.

- **Use UI funds to help companies train workers in order to avoid layoffs and better position their workers.** A number of states, including Delaware, Minnesota, Massachusetts, New Jersey, Rhode Island, and Tennessee, assess a small surcharge on the UI tax to pay for employer-based training. For example, Rhode Island assesses an additional 0.2 percent surcharge on employer UI taxes to fund an employer-based training grant program. Delaware's "blue-collar training tax" assesses a 0.10 to 0.15 percent tax on taxable wages for counseling, training, and placement of dislocated workers. Indiana adopted a training payroll tax to fund a new apprenticeship and job-training program. These programs not only improve company productivity and reduce the risks of layoffs, but also provide skills to workers so that if they are laid off they can get back to work more quickly.

- **Provide reemployment assistance vouchers to all workers who qualify for UI.** Notwithstanding the changes made in the Workforce Investment Act to set up "one-stop" job centers, many unemployed workers do not receive effective reemployment assistance, even when they go to "one-stops." While some states use WIA to create viable one-stop programs, many others do not. As a result, states should let unemployed workers receive vouchers (perhaps worth up to $250) to obtain such services. Vouchers could be redeemed (within the first month of unemployment) at certified private, non-profit or for-profit employment assistance organizations for services such as resume writing, job hunting skills, interviewing, identification of career goals, etc. Because these are vouchers, workers are free to choose any certified provider. Job search vouchers could also reenergize organized labor, which would be well positioned to capture much of this market. Because Labor already has ties to many laid-off workers, they could bid to provide comprehensive services to get these individuals back in the workforce, and by doing so, enhance their usefulness to American workers.

- **Experiment with programs to get people back to work faster.** Not surprisingly, there is evidence that more generous benefits tend to prolong unemployment spells. States have conducted various pilot projects, including back-to-work bonuses, self-employment lump-sum payments, and targeted reemployment services, that have been moderately successful in getting people back to work faster. These should continue to be used. But states should also experiment with providing workers weekly benefits that decline with the duration of unemployment. Under such an arrangement, the weekly benefit a worker would receive would decline each week. Workers would get more generous benefits than they normally would at the beginning of their unemployment, but less generous benefits toward the end of 26 weeks. This could be done in such a way as to not reduce the average weekly benefits a worker receives, but it could reduce the length of time people are unemployed.

- **Make it easy for workers to find out about and apply for unemployment insurance.** In the past few years, a number of states have allowed workers

to apply for benefits by telephone, and some states have begun to allow online applications. However, many states make it very difficult and more should be done to get information about UI online. For example, of the six major choices on the front page of Michigan's Web portal, an unemployed worker would probably click on "education and career development" and then on the sub-category "job seekers," and then on "laid-off workers" help." If she then clicked on the link for dislocated workers, she would be frustrated to not be able to find any information about unemployment insurance or how to apply.[8] If a Michigan worker is able to find the appropriate Web site, they are still not able to apply online and are told to look in the telephone book to find a local state office at which to apply.[9] Moreover, while the site explains how the program works, it fails to inform workers that they may be eligible for benefits while they are enrolled in training. Likewise, Tennessee's Department of Labor and Workforce Development home page has a link for "services for job seekers." [10] Those services do not include, however, help with UI. Such sites are not unique to Michigan and Tennessee: Many states have Web presences which only the most intrepid laid off worker can navigate to find information about UI, much less apply for benefits.

Some states, however, do try to promote unemployment insurance as a benefit that state residents should avail themselves of when in need. For example, a laid off worker going to Washington State's Web portal would find a link on the home page for unemployment insurance, which after clicking on it, would allow him to apply for UI benefits directly online.[11]

Step Four: Stop Using UI to Subsidize Companies That Lay Off Workers

Companies' UI tax rates are supposed to be experience rated, that is, the more a company lays off workers, the higher their tax rate should be. But because states cap the top rate and have a floor on the lowest rate, some companies—particularly in seasonal industries like construction and landscaping—are assessed a lower tax rate than they otherwise would be if they were fully experience rated. For example, in Massachusetts, the construction sector received 22 percent of all UI benefits but made only 9 percent of all contributions.[12] Conversely, other employers who seldom lay anyone off pay higher rates. There are within-industry subsidies going on as well, where some firms that lay off fewer workers subsidize other ones by paying a rate higher than their experience rating alone would justify.

How many firms are at the extremes of the highest and lowest rates and are therefore subsidizing or being subsidized? One study of Massachusetts found that about 5 percent of firms are in each category.[13] Nationally, approximately 18.4 percent of benefits cannot be charged back to employers because their tax rates are already at the maximum level. This is unfair to other firms who are assessed higher taxes in order to cover the shortfall of these high-layoff firms whose tax rates are already capped. Moreover, ineffective inexperience rating leads the firms already paying the top rate to bear no penalty for laying off more workers, since they can do so without seeing their UI taxes increase. Research shows that if these companies had their UI tax rate increased to adequately cover their layoffs they would reduce layoffs by at least 10 percent to 20

percent, taking two-tenths to four-tenths of a percentage off the national unemployment rate.[14] Some earlier studies found much higher effects, up to two full percentage points added to the unemployment rate because of the failure to have a system that is fully experience rated.[15]

The easy answer to this is to raise the top rates and use the increased taxes to lower the rates other employers pay. At least one state, Rhode Island, recently did this. However, it is politically difficult in many states because the firms that are already being subsidized oppose any change that would require them to pay their fair share, even though many more firms that lay off few workers would benefit by slightly lower rates. One idea would be to follow the model of the worker's compensation industry where rate schedules are set according to industry experience levels.[16] Thus, industries with very low levels of layoffs would have a lower schedule than industries with a very high one, and companies would move up or down on the schedule as they lay off more or fewer workers. Such a change would enable policymakers to lower tax rates on the large share of employers. It would also reduce the incentive firms at the top rate have for laying off workers. But this too would likely encounter political resistance from the industries assessed at a higher rate. Therefore, most states are unlikely to do this on their own since the firms at the top rate usually fight such changes. As a result:

- **Congress should require states to assess UI tax rates on employers that closely reflect the total UI benefits paid to their workers.**[17] This could be done by requiring that the UI benefits that are paid out of the state's general UI fund—that otherwise would be paid by the firm if it had been fully experience rated—can be no greater than 10 percent of total benefits paid. Congress might want to phase in this requirement over several years in order to enable the companies to absorb the tax increase. Raising the rates on companies that have high, chronic layoffs would allow states to reduce rates on a large number of employers who lay off workers infrequently. Some might object that this would penalize certain types of industries, such as seasonal employers like landscaping firms. But there is no rationale why other employers should be paying for their workers' benefits. Moreover, any negative economic impact on these sectors is likely to be made up for by the reduced layoffs the higher tax would inspire. Others might object that this would hurt weak firms who lay off workers when their sales are down. But if states adopt a reserve ratio approach to collecting benefits, as opposed to a benefits ratio approach, the immediate effects on the firm will be minimized.[18]

Step Five: Make UI Work in the Recession

Congress established a program that extends UI benefits for a minimum of 13 weeks in states that meet certain unemployment rate trigger mechanisms. But since 1983, only 12 states have triggered the program. One reason is that the measure used, the insured unemployment rate, has declined relative to the total unemployment rate as fewer workers qualify for unemployment insurance. (The insured unemployment rate is lower than the total unemployment rate). President Bush recently proposed extending benefits by 13 weeks for people who became unemployed after Sept. 11, who live in states where the unemployment rate rises by at least 30

percent, and whose benefits expire. But such a hurdle is too high. As a result:

- **Congress should lower the UI extended benefits trigger from 5 percent of the insured unemployment rate to 4.5 percent.**

Conclusion

It is time to reform unemployment insurance for the New Economy. Some of the needed changes can and should be made by states. However, to fully ensure that the system is modernized, Congress needs to act to set a baseline under which states can operate their programs. Enacted, the reforms listed here would not only help a large number of Americans cope with the New Economy, it would raise overall rates of economic growth.

Robert D. Atkinson is vice president of the Progressive Policy Institute and director of PPI's Technology & New Economy Project.

Endnotes

1. U.S. Department of Labor, "UI As An Automatic Stabilizer," http://wdr.doleta.gov/owsdrr/99-8/99-8_es.pdf.

2. Wayne Vroman, "Effects of Welfare Reform on Unemployment Insurance," The Urban Institute, May, 1998. http://newfederalism.urban.org.html/anf22.htm.

3. U.S. General Accounting Office, "Unemployment Insurance: Role as Safety Net For Low-Wage Workers is Limited," December, 2000.

4. The GAO reports that eight states would deny benefits to someone who was working the day shift but was required to work the night shift and who quit because childcare was not available. In our view, workers should not have to prove that childcare is not available. If their moving to a night shift meant that their children would be without a parent at night, they should be allowed to quit and collect UI while they look for a job that would enable them to fulfill their parental responsibilities.

5. Laurie J. Bassi and Daniel P. McMurrer; *Essays on Interstate Competition in the Unemployment Insurance System*, (Washington D.C: United States Department of Labor, Employment and Training Administration, 1996) p. 51. Http://wdr.doleta.gov/ owsdrr/98-5/98-5.pdf.

6. Stephen A. Wander and Thomas Stengle, "Unemployment Insurance: Measuring Who Receives It." *Monthly Labor Review*, July 1997, pp.15-24. (Rates in excess of 100 percent are a result of factors such as paying benefits to some job leavers and reentrants, and paying some individuals more than 26 weeks.

7. Rebecca M. Blank and David E. Card, "Recent Trends in Insured and Uninsured Unemployment: Is There An Explanation?" *Quarterly Journal of Economics*, 1991, 106:1157-1189.

8. The site, which promotes the dislocated worker program of the state, doesn't even list the location of the "one-stop" centers authorized under the Federal Workforce Investment Act. It turns out that unemployment insurance is listed under the link for "business services."

9. http://www.michigan.gov (click on the "business services" link).

10. http://www.state.tn.us/labor-wfd/.

11. http://access.wa.gov/.

12. Robert Tannenwald and Christopher J. O'Leary, "Unemployment Insurance Policy in New England: Background and Issues," (Federal Reserve Bank of Boston: April 1997) p. 24.
13. Ibid.

14. Christopher J O'Leary and Stephen A. Wandner, editors, *Unemployment Insurance in the United States: Analysis of Policy Issues*, Chapter 8, (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1997).

15. David Card and Philip Levine. 1994. "Unemployment Insurance Taxes and the Cyclical and Seasonal Properties of Unemployment," *Journal of Public Economics* 53, 1: 1-29.
16. I am grateful to Dr. Stephen Woodbury of the Upjohn Institute for Employment Research for this idea.

17. These are referred to as ineffectively charged benefits (IEC), which are not fully covered by employer taxes.

18. Tannenwald and O'Leary, *Unemployment Insurance Policy in New England: Background and Issues*, (Federal Reserve Bank of Boston: April 1997) p. 24.